THE FEDERAL RESERVE BANKS' SYSTEM OF PAR COLLECTIONS

The par collection system of the Federal Reserve banks is under fire. The par list now includes about 90 per cent of all the banks in the country, but the opponents of the plan, chiefly state bankers, have organized for a concerted effort to protect the profits which they have been accustomed to receiving from exchange charges. They have resorted to the courts and have appealed to state and federal legislatures for protection. Because of the sharpness of the controversy and its possible significance for the future of the Federal Reserve System, a presentation of the main points at issue should be of service at this time.

I. COLLECTIONS BEFORE THE FEDERAL RESERVE SYSTEM

The defects in the former clearing or collection of out-of-town checks, which gave rise to the establishment of the Federal Reserve System of check collection, are too well known to call for extended discussion. Prominent among these evils were excessive exchange charges, circuitous routing of checks, carrying of balances with collecting banks solely to obtain par territory, giving immediate credit for out-of-town checks, and heavy shipments of currency from one section of the country to another.

Excessive exchange charges are in part a survival of the stage-coach days. When the early settler went westward to purchase land, a New York draft was the safest and most convenient means of carrying funds. The land office, however, accepted only specie in payment for land. The pioneer banker charged roundly for the service of converting these drafts into coin. Undoubtedly he was warranted in doing so under the conditions then existing. According to estimates later made by Comptroller Knox, the average cost of southern and western exchange upon New York in 1859 "was not less than from 1 to 1½ per cent." In 1890 Comptroller Lacey found that the rates charged by banks in all states varied

from one to twenty-one cents per $100, the average being 8½ cents, equal to about one-twelfth of 1 per cent.[1] The higher rates were charged by banks in the West and South. By the time the Federal Reserve banks were established, many banks were making no charge for exchange and in most cases rates did not exceed from one-eighth to one-tenth of 1 per cent.

Thirty years ago the practice of making out-of-town remittances by draft instead of personal check was almost universal. Checks are more convenient, however, for the drawer and furnish him with a receipt for payment on his own paper. Checks were at first refused, but competition among jobbers forced their general acceptance, even when exchange was deducted. From the standpoint of the country bank the advantage of a check lies in the fact that during the time the check is in transit the bank has the use of that additional amount in its deposit accounts. On the other hand, the use of checks has enabled the country merchant to shift exchange charges, when collected, upon the city merchant or banker. Perhaps in many cases the country depositor is not aware that his checks are not paid at par by his bank. Sometimes the exchange charges have been absorbed by collecting banks and sometimes by the wholesalers and manufacturers.

The principal cause of excessive exchange charges has been the wastefulness of the independent system of collections. In most cases there has been no attempt at "hold-up" methods. Country clearing has simply not been handled in the most expeditious manner. Three-quarters of a century ago, even in New York City, city banks sent messengers to settle with other banks individually. Country clearing is still largely carried on in a similarly inefficient manner. To illustrate, a small bank at Clayton, just outside of St. Louis, received in one day twelve letters from St. Louis banks inclosing checks. Remittance was made to each of twelve banks by draft on its St. Louis correspondent.[2] Twenty-four letters were written and postage paid on the same, whereas a central agency could have handled all of this business with one letter each way.

[1] *Report of the Comptroller of the Currency*, 1890, pp. 14–22.

[2] Hallock, *Clearing Out-of-Town Checks*, p. 14.

In order to avoid the burden of excessive exchange charges, two practices developed which considerably increased the delay and waste in the system. In the first place, checks were sent in a roundabout manner in order to find a possible route open without exchange charges. This method of avoiding exchange charges was made possible by the reciprocal arrangement between correspondent banks to pay checks at par for one another. Cannon describes the journey of a country check drawn in Sag Harbor, New York, and paid to a Hoboken, New Jersey, firm. This check traveled eleven days, was put through ten banks, and covered approximately 1,500 miles in order to go the 100 miles between Hoboken and Sag Harbor.[1] This was an unusual case, but the practice of circuitous routing was not at all unusual. A second practice of bankers and business firms, engaged in solely to avoid exchange charges, was the carrying of balances with distant banks which in return rendered free collection services. This was especially the case where city clearing-houses prescribed uniform charges for collecting country checks. An illustration of the effects of this practice may be found in a case where a Chicago mail-order house maintained a balance with a bank in western Pennsylvania. Instead of using this bank solely to collect items in its territory, however, the Chicago firm actually sent many Illinois items to it for collection.

The practice of many commercial banks in the past has been to credit the reserve account of its correspondent bank and itself carry the "float." It has long been recognized that the chief defense of the plan was its convenience. A country bank in this way knew how its reserve account stood. No checks were charged until the country bank remitted, and checks sent to the city correspondent were counted as available reserve as soon as put into the mail. In this way a fictitious reserve was created. A check in the mail for several days might later be returned for want of funds. All of this time the various banks that had handled it would count as reserve these unavailable funds. A further result of giving immediate credit is that banks have been accustomed to allow customers the right to draw checks against uncollected funds.

[1] Cannon, *Clearing Houses*, p. 74.

In order to eliminate unnecessary labor and expense in the clearing of out-of-town checks, various reforms had been worked out before 1913. The most successful plan in operation at that time was the Boston Country Clearing House. By this system, instituted in 1899, Boston was clearing all New England checks.[1] Had this system been general it would not have been necessary for the framers of the Federal Reserve Act to include the clearing function among the powers of the Federal Reserve banks. It is not unlikely that it would sooner or later have been more widely adopted. A similar plan was in use in Kansas City and Detroit. At a meeting of the reserve city bankers in St. Louis in April, 1913, a plan of country clearing was indorsed. This proposed plan was submitted to the banks in the fifty reserve cities but it was impossible to obtain general agreement for the measure. It would have been a very slow process to win nation-wide support for the Boston plan. For this reason the Federal Reserve Act wisely provided the means for setting up a universal system. The Boston, Kansas City, and Detroit country clearing arrangements were easily absorbed into this larger plan.[2]

II. THE FEDERAL RESERVE COLLECTION SYSTEM

The Federal Reserve Act permitted the Federal Reserve banks to exercise the function of collecting checks for member banks. Because of the technical problems involved and the probability of disturbing established practices it was decided not to put this feature of the law into operation when the banks were established in 1914.[3] Early in 1915 the Federal Reserve Board inaugurated a voluntary clearing system in all of the Federal Reserve districts.[4] Such a small proportion of the member banks voluntarily affiliated themselves with the clearing system, however, that the Board decided in April, 1916, to make the system compulsory for all member banks.[5] By an amendment passed June 21, 1917, non-

[1] Hallock, *op. cit.*, pp. 50–112.

[2] McKay, *Bankers' Monthly*, April, 1920, p. 29.

[3] *First Annual Report of the Federal Reserve Board*, 1914, pp. 19–20.

[4] *Second Annual Report of the Federal Reserve Board*, 1915, pp. 14–17.

[5] Regulation J, Series of 1916. *Third Report of the Federal Reserve Board*, 1916, pp. 169–71.

member banks and trust companies were also permitted to become clearing members of the system. This enabled any non-member bank to use the collection facilities of the Federal Reserve bank by maintaining therewith a balance sufficient to offset items in transit and agreeing to remit at par for checks forwarded by the Federal Reserve bank. At the outset several large non-member banks opened clearing accounts, but as most of these institutions have since become members of the system the number of non-member clearing accounts has never been large.[1]

The amendment of June, 1917, allowed member and non-member banks to make reasonable exchange charges for checks presented by other banks but it expressly provided that "no such charges shall be made against the Federal Reserve banks."[2] Against this provision, commonly known as the Hardwick amendment, the exchange-charging member banks made a determined fight but they were unable to defeat the measure. All member banks were thus compelled to remit at par. In response to the Federal Reserve Board's request for interpretation of this provision, the attorney-general ruled that checks on non-member banks making exchange charges could not be collected by the Federal Reserve banks.

All member banks are therefore required to pay, without deduction for exchange, checks drawn upon themselves and remitted to them through the mails by the Federal Reserve bank. The member banks are permitted to settle for such checks by acceptable checks or drafts upon other banks, by check upon their own reserve account with the Federal Reserve bank, or by the shipment of currency at the expense of the Federal Reserve bank.

Checks drawn upon a member bank cannot be charged against its reserve account until sufficient time has elapsed for the returns to reach the Federal Reserve banks. In like manner, while the credit entry for all checks sent in by member banks is made immediately, the proceeds of such checks cannot be counted as part of the minimum reserve nor become available to meet checks drawn until

[1] *Fourth Annual Report of the Federal Reserve Board*, 1917, p. 13.

[2] Governor W. P. G. Harding's report to the Senate, *Senate Document No. 184*, 66th Congress, second section, p. 3.

actually collected. A time schedule is furnished to each member bank which enables it to determine the time at which any items sent to the Federal Reserve bank will become available. The time schedule has been worked out on the basis of the mail time required for items to reach the paying bank plus the mail time required for the paying bank to remit to the Federal Reserve bank of its district. To illustrate, rules of the New York bank give immediate credit for checks on nearly all of the New York banks; one day is required for checks on Boston, Philadelphia, and other nearby points; most points in the East require two days; and the maximum time is eight days for points in the extreme West.[1]

When the compulsory system was established for member banks, the Federal Reserve banks also undertook to collect for their members, or clearing members, checks on all non-member banks that would agree to remit for the same at par. Member banks were furnished with a par list, including at that time about 15,000 banks, to which from time to time other banks have been added. It is chiefly in connection with the extension of this par list to include involuntary non-member banks that the present controversy has arisen.

At first the costs of collection, averaging about one and one-half cents per item, were assessed upon member banks in proportion to the extent to which they used the collection facilities. In 1918 all service charges were abolished and the Federal Reserve banks also assumed the costs of postage, telegrams, insurance, and other expenses (between the member banks and Federal Reserve banks in connection with check collection, currency shipments, exchange transfers, and deposit transactions). Practically the same facilities were afforded the clearing member banks. For non-member banks on the par list stamped envelopes were inclosed with collection letters for return remittances and all expenses incident to the shipment of currency made in payment of items sent for collection were also assumed by the Federal Reserve banks. The argument made by country banks for refusing to remit at par because of expense was thereby effectively met.[2]

[1] Circular No. 258 of the Federal Reserve Bank of New York, March 1, 1920.

[2] *Fifth Annual Report of the Federal Reserve Board*, 1918, pp. 75–77.

III. THE GOLD SETTLEMENT FUND

In order to make its facilities for the collection of checks nationwide, the Federal Reserve Act authorized the Federal Reserve Board, at its discretion, to exercise the functions of a clearing-house for the Federal Reserve banks. To carry out this feature of its work the Board, in May, 1915, prepared regulations for the establishment of what is known as the gold-settlement fund at Washington. Since July 1, 1918, district clearings have been made daily by special leased wire connecting all of the Federal Reserve banks and their branches. At 10:00 A.M., eastern time, each bank wires the settling agent of the Federal Reserve banks, in charge of the books of the fund, the amount it has credited to other Federal Reserve banks the previous day. Transfer of funds from the credit of one bank to that of another is effected by means of book entries.[1] Through the gold settlement fund, therefore, a member bank can transfer money without cost to any point where there is a Federal Reserve bank or branch. This automatically eliminates exchange charges between Federal Reserve cities.[2] By means of the gold-settlement fund, checks on banks in the 33 cities having Federal Reserve banks or branches are made available the day they *reach* their destination. In this way the time for collection of items on these cities is cut in two.

IV. GROWTH OF THE PAR COLLECTION SYSTEM

By the end of 1918 the system was well established and the volume of transactions had increased enormously. The average number of items handled daily during the year 1917 was about 276,000; for the thirty-day period ending November 15, 1918, the daily average was 828,000. This increase in volume of business was very satisfactory, but the additions to the number of non-member banks on the par list was less gratifying, amounting to only 1,985 during the year. The total number of banks on the par list at that time was 19,021, out of a total of about 29,000 commercial banks in the entire country. Although this number

[1] *Annual Reports of the Federal Reserve Board*, 1915, pp. 77; 1917, p. 24; 1918, pp. 32–35.

[2] McKay, *op. cit.*, April, 1920, p. 56.

represented about 90 per cent of the total banking resources of the country, the number of banks whose checks could not be handled by the Federal Reserve banks was sufficiently large to make many banks hesitate to rely on the Federal Reserve collection system.

A conference of Federal Reserve agents was therefore held on December 7, 1918, at which the conclusion was reached that every effort should be made to extend the par list.[1] During 1919 and the early months of 1920 this campaign was vigorously pressed forward. Representatives of the Federal Reserve banks visited the non-par points for the purpose of securing the co-operation of the banks. Every effort was made to persuade the banks voluntarily to agree to remit items at par. The results in general were very gratifying. During 1919 about 6,000 banks were added to the par list. On March 15, 1920, there were 27,494 banks on the par list and only 2,274 banks not so included. On April 1, 1920, Washington, Oregon, Arizona, and the eight South Atlantic and Gulf states east of Texas were the only states in which not all the banks were included.[2]

In extending their collection facilities it was the policy of the Federal Reserve banks, as soon as the number of non-member banks in any district not on the par list became small, to undertake the collection of all checks drawn on non-member banks of the district. The collection of checks on banks unwilling to remit directly at par was effected by means of an appropriate agent. This agent might be a member bank located in the same city or in some cases a non-member bank, an express company, or other suitable person or corporation which could present the checks to the drawee bank over its counter for payment. As soon as checks on all banks in any state could be collected either by forwarding items direct or through agents, the entire state was included in the par-point list. On January 21, 1920, there were 43 banks in the Minneapolis district collected through agents, 19 in the Chicago district, 6 in the New York district, 2 in the Cleveland district, and none in the Philadelphia district. The other districts did not report their numbers but some of them had little par territory,

[1] *Fifth Annual Report of the Federal Reserve Board*, 1918, pp. 75–77.

[2] *Federal Reserve Bulletin*, April, 1920, pp. 417–18.

while all the banks in the Boston district were included in the par list.

When a Federal Reserve bank decided that its facilities were such as to warrant its doing so, all non-par banks in an entire state were notified that they were to be placed on the par list and that it was optional with them whether the checks would be presented at their counter for payment or sent to them direct for payment in suitable exchange without deduction for exchange charges.[1] The par list has therefore included many banks which were remitting directly, besides those collected through agents, which were doing so against their will.

V. THE OPPOSITION TO THE PAR COLLECTION SYSTEM

In thus extending the par list to include involuntary non-member banks, decided opposition has been encountered. Banks which have been accustomed to collecting exchange on all checks drawn upon their own deposit accounts do not willingly forego this element of profit. In some cases the banks resorted to the time-worn practice of tendering silver dollars in payment. In other cases they placed notations on their checks to protect themselves from the necessity of paying through the agents of the Federal Reserve banks.[2] In cases where this notation appears on checks, the Federal Reserve banks have no option but to turn the checks back to the member banks which deposited them. The inability of the Federal Reserve banks to handle such checks has been an inconvenience to the member banks.[3]

[1] Governor W. P. G. Harding's report to the Senate, *Senate Document No. 184*, 66th Congress, second session, pp. 33–34.

[2] Typical examples of check notation are: "not payable through the Federal Reserve bank, their branches or agents, nor express company or post-office"; "not payable through the Federal Reserve bank"; "this check will not be paid through express companies, post-offices, or any Federal Reserve bank or its agents." The interested bankers secured an opinion from Counsel Paton of the American Bankers' Association to the effect that checks bearing such notation on them were valid, negotiable instruments.

[3] One of the correspondent banks of an unusually persistent rebel wrote suggesting that the notation be left off of its checks. The cashier replied that he objected to the Federal Reserve bank handling any item drawn on that bank and added, "At the present time we are running this bank, and when you start to take charge please advise us the day before your arrival."

The stiffest local fight against par collections appears to have taken place in Pierce County, Nebraska. The situation there was dominated by Wood Cones, president of the Cones State Bank of Pierce, who had the support of other bankers connected with both member and non-member institutions. In a deposition presented as evidence in the Georgia courts, Mr. Cones presented the facts concerning the fight from his standpoint. When asked by the representative of the Federal Reserve bank to remit at par he refused to do so. Checks were then sent to the local express agent for collection in cash. Cones offered him silver dollars for the checks, which the agent refused to accept owing to the time necessary to count out the amount. He therefore accepted an Omaha draft. Following this, a representative of the Omaha branch of the Federal Reserve bank presented certain checks for payment but was refused currency without more satisfactory identification. Mr. Cones charges that the bank's representatives threatened him in various ways, including an attempt to promote a national bank. On one occasion, according to his testimony, they presented checks for payment in cash aggregating $31,900, about $13,000 more than his legal reserve requirement. Finally, he claims, for several weeks an agent of the bank and later a notary public were maintained in Pierce merely to present checks and protest the same when payment was refused.[1]

The officers of the Federal Reserve bank of Kansas City, in answering a request from Governor Harding for information concerning alleged coercive measures, stated that the bankers of Pierce had so intimidated the people of the town that unusual means were necessary. The express agent refused even to transmit the currency presented by the bank messenger, and local notaries were not available for protesting checks. Under these conditions a visit to Pierce by automobile was necessary in order to take the funds out of town and to bring in an outside notary. The cost of such visits justified them in accumulating several days' checks for collection at once. Under such circumstances the unusual amount claimed by Mr. Cones might easily be correct.[2]

[1] *An Instance in the Superior Court of Fulton County, Georgia.*

[2] Governor W. P. G. Harding's report to the Senate, *Senate Document No. 184*, 66th Congress, second session, p. 35.

On January 14, 1920, a special meeting of the state bankers of Nebraska was held at Omaha to consider the matter of par collections, Mr. Cones being one of the speakers. The methods followed by the Federal Reserve banks were condemned and resolutions passed requesting representatives in Congress to demand an investigation of the practices of the Federal Reserve Board. The matter was presented in the Senate by Senator Norris of Nebraska, and on January 19, 1920, a resolution was passed "instructing the Federal Reserve Board to inform the Senate if the Federal Reserve System has resorted to coercive measures to compel state banks to join it or to submit to regulations made by it."[1]

In response to the Senate resolution, Governor W. P. G. Harding sent to the Senate, under date of January 26, 1920, a complete statement of the position of the Board.[2] Attached to his report were telegrams from all of the Federal Reserve banks explaining the methods used by them in handling collections. Only four of the banks—Kansas City, Dallas, Minneapolis, and Chicago—reported any instances in which they had accumulated checks when collecting through an agent. In no case was this done to embarrass the payee bank but solely to save expense in collection; this was, moreover, in pursuance of the practice generally followed by large commercial banks. On the whole Governor Harding's report is an excellent defense of the system and has called forth favorable comment in the financial papers of the country.

The fight against par collections has also been very determined in the southeastern states. On March 6, 1920, the Mississippi Legislature passed a law making it mandatory on the banks of the state to charge exchange on checks, drafts, bills, or other cash items when collecting and remitting for the same.[3] The law, moreover, specifies that the rate charged shall be one-tenth of 1 per cent and not less than 10 cents on any one transaction. Exception is made in the case of checks due to the state of Mississippi or any of its subdivisions or to the United States, and no

[1] Senate Resolution, No. 284, 66th Congress, second session, *Congressional Record*, LIX, 1778.

[2] *Senate Document No. 184*, 66th Congress, second session.

[3] House Bill No. 561.

charge may be made against checks on a bank in the same municipality, "this being the long-established custom." It is also made optional with the bank whether or not exchange will be charged on checks or drafts payable to a person in the state. The law also prohibits officers of the state from protesting such "cash items," when non-payment is solely on account of refusal to pay the exchange. The constitutionality of the law is in such grave doubt that the lawmakers themselves provided that in case the courts hold that the national banks are not required to charge exchange, "this act shall still remain in full force and effect as to all other banks in the state." For the protection, however, of state banks that must compete with national banks which, for this reason, do not charge exchange, it then becomes optional whether such charge shall be made by state banks. The law was made effective immediately (March 8) after its passage, but the question of constitutionality is still (May 20) to be settled by the courts. Meantime the Federal Reserve banks have declined to handle checks on Mississippi banks which were formerly on the par list.[1]

In Georgia the banks have resorted to still another method in their attempt to nullify the provisions of the Federal Reserve Act pertaining to check collection. On January 15, 1920, the Superior Court of Fulton County issued a temporary injunction against the Federal Reserve bank of Atlanta to restrain the bank from putting into operation any methods against the petitioning banks to compel them to remit checks at par. The state court permitted the removal of the case to the federal courts, which decided early in April in favor of the Federal Reserve bank.[2]

In asking for this injunction the plaintiffs charged at least three oppressive and annoying methods of check collection being used against them: first, sending a special messenger; second, hiring a special agent; third, transmission of checks through the local postmaster or through the express companies for collection in

[1] *Cincinnati Enquirer*, March 19, 1920. Circular letter of the Federal Reserve Bank of St. Louis, dated March 19, 1920.

[2] *United States Investor*, March 13, 1920; April 17, 1920, p. 815; *Federal Trade Information Service*, Washington, D.C., XII, No. 9, 562.

currency over the counters of the bank on which they are drawn. Against the first of these methods it was objected that checks are accumulated until a large aggregate amount is on hand. This forces the small bank to carry an unnecessary amount of cash in its vaults to meet unexpected demands. "In addition to this," complains the petition, "the appearance in a small village or town of a stranger and unknown person in an automobile or other conveyance and his subsequent withdrawal under the eyes of the attendant and curious crowd of country people of large sums of currency from the local bank, the same to be carried away in the presence, perhaps, of many of the depositors of said bank, is calculated to, and in all probability would, result in an immediate run on said bank that would promptly put it out of business." Against the use of either of the two types of local agencies for collection of checks the bankers urged that the expense of the Federal Reserve bank was greater than the charges made by the banks. The petitioners allege that the Federal Reserve banks have adopted these methods to force country banks to remit at par in order to compel them to become members of the system. Less than 2 per cent of the country banks in Georgia have voluntarily become members, and this small response they hold to be a disappointment to the officials of the Atlanta bank. But, they say, "there is no warrant in law for perverting the Federal Reserve Act into an instrument of autocratic tyranny to compel petitioners and other banks created by the state of Georgia to sacrifice their charter rights and legitimate revenues to fatten the swollen profits already piling up in the Federal Reserve bank, which at present are about one and three-eighths times as great as their aggregate capital stock."

In sections where the par collection controversy has been most sharp, the state banking officials have been ardent supporters of the cause of the state banks.[1] Support has also been secured from the State Bank Section of the American Bankers' Association, which, at its convention in St. Louis, September 30–October 2, 1919,

[1] *Cincinnati Enquirer*, February 3, 1920; *Federal Trade Information Service*, XV, No. 30 (May 5, 1920), 334; *New Orleans Times*, February 2, 1920.

went on record against the methods used in order to secure par collections.[1]

In regard to the extent to which "strong-arm" methods have been used against the banks which have refused to remit at par, the testimony of the country bankers and that of the Federal Reserve authorities conflict somewhat. Perhaps better feeling might have been promoted by a little less zeal on the part of the Federal Reserve banks in their efforts to extend the par list. On the whole, however, the policy of the Board and of the Federal Reserve banks appears to have been to use every effort to induce the banks to agree willingly to par remittance. Only when they have met obstinate opposition have the representatives of the banks exercised their legal right to demand payment in cash.

In more recent weeks the question of method has become subordinate and the opposition has now concentrated upon the principles of par collection as such. Organized sentiment by the bankers opposed to any form of par remittance was definitely crystallized by the formation of a national association in New Orleans on February 6, 1920. There were a number of national banks represented at the meeting. The organization was therefore named the National and State Bankers' Protective Association. The meeting was called by D. B. Claiborne, president of the Louisiana Bankers' Association, in order to organize the banks in all of the states of the sixth Federal Reserve district to carry on the par clearance fight. Invitations were, however, sent to bankers in other states, with the result that representatives came from several other districts.

Among the resolutions adopted by the assembly may be found certain statements which are in effect a very strong demagogic appeal to public opinion in opposition to the Federal Reserve System. In some respects, indeed, the framers of the resolutions rather overdid the criticism. For instance, they charged that the Federal Reserve banks, during the year 1919, made the enormous sum of $98,000,000 on a paid-in capital of a little over $87,000,000. In bringing forward this charge, no mention was made of the fact that the stockholding banks cannot profit beyond a 6 per cent

[1] *Journal of the American Bankers' Association*, XII, No. 9, 562.

cumulative dividend. Again, they asserted without undertaking to prove that salaries paid to employees in the Federal Reserve banks are out of proportion to the pay for similar work in privately owned institutions. The concentration of financial power under this system was contrasted with that of "money trust," which concentration the system was expected to cure.

The resolutions called upon Congress to investigate the general policies of the banks, and so to amend the Federal Reserve Act as specifically to prohibit Federal Reserve banks from handling either for deposit or collection any checks drawn on non-member banks unless such non-member maintains a clearing account with some Federal Reserve bank. Finally, Congress was requested to make further amendments, after investigation, "so that it may be no longer possible for an instrument of great good to be used as a weapon of oppression."

In pursuance of plans made at the meeting, a pamphlet letter, containing a copy of the resolutions adopted at New Orleans on February 6, the Georgia injunction proceedings, the Mississippi law against par clearance, and certain other letters and resolutions, was prepared and sent out to all banks in the United States. Banks in sympathy with the purpose of the association were asked to write or wire their senators and congressmen.

On February 28, 1920, Representative King of Illinois introduced a resolution for an investigation of the Federal Reserve System in response to the demand by the new bankers' organization formed at New Orleans.[1] The resolution was referred to the Committee on Rules for consideration, and as yet no definite action has been taken thereon.

The association representing the bankers opened a strong lobby in Washington early in May to urge that Congress adopt the King Resolution.[2] To meet this lobby, representatives of the Federal Reserve Board also appeared before the House committees to deny

[1] House Resolution No. 476, 66th Congress, second session, *Congressional Record*, LIX, 3895.

[2] In connection with the general fight against the collection system, at least two bills had been introduced into Congress prior to the submission of the King Resolution, which, if passed, would nullify all of the achievements of the Federal Reserve banks in the establishment of a universal system of par collection of checks

the charge of coercive measures and to support the position of the Board. Finally, the Federal Reserve Board and the country bankers agreed that the Board was to address a letter to the House Committee on Banking and Currency suggesting a hearing on the merits of the question, at which the Federal Reserve Board, member banks, and others supporting the system, as well as those opposing it, should be given a full hearing. In accordance with this agreement Congress has been asked to grant a full hearing to both sides and then to adopt one of two courses: (1) report a bill authorizing member and non-member banks to charge exchange on all checks sent them by the Federal Reserve banks, the cost of this exchange to be charged by the Federal Reserve bank to the banks depositing the checks for collection; or (2) report a bill definitely establishing the right of the Federal Reserve banks to collect checks on any bank without exchange deductions. In case a bank refused payment, penalties would be imposed in order to insure compliance therewith.

In either case the provisions of section 13 would be clarified. Adoption of the first course would nullify the work thus far done by the Board; adoption of the second course would insure universal par collections. The issue is now squarely before Congress to decide whether the par collection system shall be abolished or the Federal Reserve Board shall be given the means for overcoming existing obstacles.[1]

The more drastic of these (House Resolution No. 12,379), introduced by Representative Steagall on February 6, 1920, would eliminate entirely the power of the Federal Reserve Board over exchange rates charged by member or non-member banks. Banks would be permitted to charge all banks, the Federal Reserve banks included, a maximum of ten cents per hundred dollars or fraction thereof. The same witnesses who appeared before the Rules Committee on May 4 to urge the adoption of the King Resolution also appeared before the House Committee on Banking and Currency to ask for favorable action on the Steagall bill. The second bill (House Resolution No. 12,646), introduced on February 20, 1920, by Representative McFadden, would strike from the present act the clause which states that "no such charges shall be made against the Federal Reserve banks." The passage of this bill would still leave the power to fix maximum charges with the Federal Reserve Board but would permit member or non-member banks to impose their charges on the Federal Reserve banks. The great gains made during the past three years in extending the par list would be lost and the system placed in the same position as it was before the enactment of the Hardwick Amendment.

[1] *Federal Trade Information Service*, XV, No. 31 (May 6, 1920), 246; XV, No. 34 (May 10, 1920), 265–66.

In making a decision Congress is therefore called upon to settle the main issue as to the advantages and disadvantages of a system of universal par collections. We shall now analyze the arguments advanced by the country bankers in defense of their position and show to what extent the federal reserve plan is meeting the former defects.

VI. THE QUESTIONS AT ISSUE

In defense of their position the exchange charging banks urge, first, the extra cost which they claim is involved in the handling of checks through the mail. In some instances banks have also urged that the ease with which payments can be made by means of checks encourages the purchase of goods from mail-order houses and other out-of-town concerns.[1] In their brief the Georgia banks urge that the exchange costs fall on the city wholesale or retail merchant who recoups himself out of his profits on the sale. It is quite obvious that if exchange were universally charged this expense would be included in the selling price of goods and that the burden would thus fall on the consumers of the goods. In so far as one bank makes such charges and another does not, the burden is unfairly distributed to the country as a whole. But, when all other arguments fail the bankers, they fall back on the statement that these charges have been customary in the past and have constituted such a large percentage of their profit that without them they could not live. In their petition for an injunction against the Federal Reserve Bank of Atlanta the Georgia banks maintain "that compensation for said service constitutes one of the most important sources of revenue of the country banks and the continuation of the right to make such charge is essentially important to their continued prosperity."[2]

The writer is not familiar with banking conditions in Georgia, but considerable experience with small country banks in the Mississippi Valley, some of which charged exchange and others did not, leads him to believe that the assumption that many of these could not live without exchange is unwarranted. On the

[1] *Federal Trade Information Service*, XV, No. 25 (April 29, 1920), 193.

[2] *Journal of the American Bankers' Association*, XII, No. 9 (March, 1920), 498–505.

whole the efficiently managed country bank has just as profitable and legitimate a field of operation as have the city banks. Their expenses are small, their capital requirements are likewise very small, and the volume of business is about in proportion to that of the larger institutions.[1] In any case the burden of maintaining these institutions should not be shifted to the city bank or merchant. Obviously the country bank's depositor is the one who profits by having a banking institution in his community. If he buys goods of the city merchant it is usually his duty to make the settlement at the point of purchase. In most cases, therefore, the exchange, if paid, should be borne by the drawer of the check. As we have pointed out, however, the cost of remitting for checks presented by the Federal Reserve banks is not great. The costs of postage and shipping of currency, when necessary to make remittance, are borne by the Federal Reserve banks. When checks are mailed to a bank they are all properly listed and a return-remittance form letter is inclosed with every outgoing transit letter; the drawee bank merely incloses an acceptable draft and returns the letter. The opinion of bankers is that less clerical service is required to handle a given amount of such business through the mail than to pay the same number of checks over the counter. The bank therefore is only warranted in making the customer bear this expense when the balance maintained in his account is so small that it would be warranted in assessing a monthly service charge against his account.

In this respect the country banker is in a peculiarly hard position. Depositors have been encouraged to believe that any account, however small, is profitable to the bank. It would probably not be feasible, therefore, to adopt the practice of many city banks of making a service charge against checking accounts. City banks have also either required their customers to pay a service charge for the out-of-town collection items deposited, or

[1] Statistical data for comparative purposes are not generally available. The report of the superintendent of banking in Ohio for the year ended December 31, 1919, shows that the percentage of net earnings to capital in the 511 banks outside of the larger cities was 21.5 per cent. In the 112 state banks located in the eight largest cities of the state the net earnings averaged somewhat higher, ranging from 12.5 per cent in Columbus to 35.4 per cent in Akron.

have refused to give credit for these items until the remittances are received. This would appear to be a legitimate source of income for country banks, to offset any loss of exchange which they might sustain if they are compelled to remit for items drawn on them without making any charge. Again, however, the practicability of such an arrangement for banks in the rural communities is somewhat questionable. The practice has been for the country banks to take these items from their depositors without any charge. These factors may make the position of some country bankers particularly hard during the readjustment period. This situation does not warrant maintaining exchange charges permanently on the plea of vested rights; but it might make it desirable to give more opportunity to these bankers for readjusting their business methods. If these bankers would suggest some modification in the clearing system, at once correct in principle and practicable in operation, which would be in their interest, some effort could then be made to meet their difficulties. Instead, they have chosen to attack the entire clearing plan.

The second objection, frequently made on behalf of the non-member banks, is that they receive no advantage in return for the giving up of exchange charges. If an Ohio country bank arranges with the First National Bank of Cleveland, e.g., to remit at par for all checks presented by the latter, it does so to secure certain definite reciprocal advantages. Before the same bank agrees to relinquish the right to charge exchange on checks presented by the Federal Reserve bank of Cleveland, the question is naturally raised as to why it should be asked to do so. Non-member banks may maintain a clearing account with the Federal Reserve bank and thus participate in its clearing and collection system. Until the par list is universal, however, it is necessary to collect on non-par points through other channels. This necessitates the use of correspondent banks. Moreover, there are certain advantages now granted to country banks by their city correspondents which the Federal Reserve banks are not in a position to offer. City banks allow interest on the average daily balance, and they sometimes accept checks for immediate credit and thus carry the "float." They assist country banks in making investments, when

they have surplus funds, and also furnish them with credit when that is needed.

Whenever the par system becomes universal there will be some direct gain for non-members that wish to maintain clearing accounts. Meantime most of the general gains from the system are shared indirectly by the country bank through the medium of its city correspondent, which is almost invariably a member of the system. All checks sent by the country bank to its city correspondent for collection are now handled with a minimum of time, effort, and expense. These benefits it receives gratis. Looked at from the selfish interest of the non-par banker these advantages may not seem sufficient to induce him to relinquish voluntarily his privilege of deducting exchange charges. But as Governor Harding states in his communication to the senate:

> That a relatively small number of non-member banks should not want to become members of the clearing system or should not want to remit at par is, of course, their own concern and the Federal Reserve Board and the Federal Reserve banks have not and will not dispute their right to decline to do so. But that those same few non-member banks, which through their member-bank correspondents are able to obtain the benefits of the par collection system gratis, should decline to become clearing members, cannot and should not deter the Federal Reserve banks in the exercise of their undoubted legal right—the right to collect over the counter in cash or satisfactory exchange, by means of an agent, checks drawn on a bank which for one reason or another does not care to remit at par for checks mailed to it directly.

Of the defects of the former system of check collection, the first one noted, excessive exchange charges, has been effectively remedied. "Exchange" charges have been largely eliminated in the districts which include all par territory. In part the saving to the public is borne out of the profits of the Federal Reserve banks. In considerable part, however, it is the result of the elimination of economic waste. Uniformity and centralization have reduced the amount of circuitous routing, eliminated unnecessary mail, materially reduced the time for collection, and rendered shipments of currency between different sections of the country almost unnecessary. The officers of the Federal Reserve Bank of Chicago state that the cost of the transit business handled by that bank in 1919 was about one-half what it is in the best managed commercial

banks.[1] In 1919, $73,934,252,000 of inter-district clearings were handled by the Federal Reserve banks through the gold settlement fund at a total cost, including the leased wire service, compensation of accountants, etc., of $250,000, about $3 for each $1,000,000 so transferred. This cost was all absorbed by the Federal Reserve banks. If charged to the public at the rate of one-tenth of 1 per cent, it would have involved an expense of $1,000 for each $1,000,000. In addition to these inter-district settlements there were about $70,000,000 of intra-district clearings.[2] If the whole volume of this business had been charged one-tenth of 1 per cent, the cost of the 1919 business would have been about $140,000,000. A large amount of this business would not have been subject to exchange charges under former arrangements, but the amount collected would have been considerable.[3]

Circuitous routing of checks has been largely eliminated merely by reason of the opportunity to use the facilities of the Federal Reserve banks. But, in order to insure direct routing of all checks coming through their transit departments, the Federal Reserve banks will not even accept checks drawn on a bank located in one district which bear the indorsement of a bank outside of that district. Moreover, whenever time can be saved in collection, a member bank may arrange to send checks and drafts direct to the Federal Reserve bank or branch bank of any other district in which such items may be payable. All member banks are given instructions concerning how best to route items within a district, where there are branches, in order to reduce the time of collection to a minimum. Banks are advised to print on their checks a large skeleton figure signifying the number to the Federal Reserve district. For the information of correspondent banks and in order to stimulate use of the Federal Reserve System they are also urged to print the words "collectible at par through the Federal Reserve Bank of ———."[4] There has been no attempt to supersede

[1] McKay, *op. op.*, April, 1920, pp. 29, 56, 58.

[2] *Sixth Annual Report of the Federal Reserve Board*, 1919, pp. 40–46.

[3] Governor W. P. G. Harding has estimated the savings already made at $135,000,000 annually. The state bankers in Georgia maintain that they will lose $1,000,000 per year if deprived of their exchange charges.

[4] Regulations of the Federal Reserve Bank of Cleveland.

methods already efficient. City clearings are still effected by means of the clearing-houses, but in most of the 33 cities having Federal Reserve banks or branches the settlements are effected by a transfer of balances at the Federal Reserve bank or branch. Where banks in adjoining communities can save time by direct collection, they are not expected to use the Federal Reserve System.

The practice of giving immediate credit upon deposit of checks and drafts has been done away with, as far as the Federal Reserve banks are concerned, by the method of deferring credit until remittance is received. It is impossible therefore to pad bank reserves with items in transit. It would contribute a great deal to the acceptability of the Federal Reserve plan to many of its member banks if a scheme for giving immediate credit for checks deposited could be worked out. At first sight the clearing plan seems to be more practical and simple in operation than the present method of check collection.[1] The Federal Reserve Board raised the question of whether immediate credit should be given for checks before any plan was instituted. Expert opinion was sought and a system of full clearing was favored.[2] This plan, which in theory promised so well, was given a trial but in practice proved unsatisfactory. During the operation of the voluntary plan of clearing, checks on member banks were credited on receipt to the depositing member bank's reserve account and charged to the drawee member bank's account. Checks were thus made immediately available. But it was found that there were very large overdrafts in the reserve accounts upon which the checks were drawn. The total amounted on some occasions to several million dollars. The practice of making checks immediately available had therefore to be abandoned.[3]

It has been suggested that the Federal Reserve banks might well grant immediate credit for checks and carry the "float."

[1] "A check is said to be collected when it is sent home to the bank on which it is drawn and arrangement is made to remit the proceeds; it is said to be cleared when the bank receiving it offsets it against checks in favor of the institution by which it is to be paid, and then collects or remits only the balance, if any."—Willis, *The Federal Reserve*, p. 223.

[2] *First Annual Report of the Federal Reserve Board*, 1914, pp. 138–48.

[3] *Bankers' Monthly*, April, 1920, p. 29.

The theory of crediting a bank or depositor for uncollected, and perhaps uncollectible, funds is unsound and, as a practical proposition, it would seriously limit the rediscount power of Federal Reserve banks. The total in the deferred availability account amounts to from $500,000,000 to $800,000,000.[1] It is impracticable to make the Federal Reserve banks tie up funds to this amount while checks are in process of collection.

If a plan could be worked out for clearing checks, there would be no reason from the standpoint of the Federal Reserve banks for delaying credit for checks on member banks. In such a case the total reserve would not be affected. The former difficulties experienced by banks with overdrafts in their reserve accounts seem to make this impossible at present. Later, if a universal par system is worked out, the offsets may be more nearly equalized and a clearing plan may then be practicable. At present the deferred-credit plan seems to be the only one feasible.

Meantime there is an advantage possessed by a bank located in a city having a Federal Reserve bank or branch in being able to offer the prospective correspondent bank the opportunity of drawing drafts which are immediately available. As matters now stand, individual banks located in other cities cannot be granted the privilege, even when willing, of having their reserve account charged immediately for their checks or drafts. Such an arrangement would seem to give a bank an advantage over its local competitors. If, as was the case in Pittsburgh before the branch bank was established there, all of the member banks in any city will consent to having their reserve accounts charged immediately, the Federal Reserve banks will consent to such an arrangement.

Universal adoption of the present principle of par remittance does not necessarily mean that any bank check or draft will be paid at par or accepted by a bank for its depositors for immediate credit. A charge for the time taken to convert checks and drafts into available funds may very properly be made against the depositor. The sound method, in such a case, is for the bank to make a service charge equal to the interest upon the amount for the time necessary to make the funds available. This plan is now

[1] *Commercial and Financial Chronicle*, CX (May 18, 1920), 1951.

used by the clearing-house banks of New York, Chicago, St. Louis, Minneapolis, and other cities.[1]

It is within the power of the Federal Reserve Board to regulate exchange charges made on this basis. In view of the argument being made in some quarters that city banks are profiteering and that the benefits of par remittance are not going to the public in reduced charges, the time seems opportune for the Board to make a general revision of schedules.[2] If this is done, the Federal Reserve Board should doubtless make it optional with the banks or clearing-house associations whether or not such charge is collected. For good customers who maintain generous balances there might be no reason for making such a charge unless prescribed by the clearing-house for the sake of uniformity. Where the bank cashes checks for the accommodation of outsiders or for customers who immediately use the funds, the interest charge should be imposed. If such a schedule is drawn up by the Federal

[1] The revised regulations of the New York Clearing House, effective May 1, 1920, provide a schedule of charges to be made on all checks or drafts which are collected by the members of the association for depositors. The rates are adjusted to conform to the time schedule for the Federal Reserve Bank of New York. There is no "exchange" charge at all but merely a charge sufficient to cover the interest on the items until the money is available. On checks which are available immediately or within one day after deposit, the charge is discretionary. Nearby cities may thus be collected without charge, therefore a large percentage of all checks received will not be subject to any deduction. On items available two days after receipt the charge will be one-fortieth of 1 per cent; for such items available four days after receipt the charge shall be one-twentieth of 1 per cent; and for such items available eight days after receipt one-tenth of 1 per cent. (These rates represent interest on the amount involved at about $4\frac{1}{2}$ per cent per annum.) In any case the minimum charge is ten cents, but this minimum may be based on all items in any one deposit. These charges must be collected in all cases and "no collecting bank shall directly or indirectly allow any abatement, rebate, or return for or on account of such charges or make in any form, whether of interest on balances or otherwise, any compensation therefore." Stringent penalties are prescribed for violation of this provision (*Commercial and Financial Chronicle*, CX [April 17, 1920], 1593–95).

[2] In stating the case for the country bankers Mr. E. M. Wing, president of the Batavian National Bank of LaCrosse, Wisconsin, explained the system of interest and service charges imposed by the banks of the large cities. On the other hand, country banks are compelled to take such items from their depositors without charge. They are therefore deprived of all exchange charges, and the revenue they have been accustomed to receiving therefrom is diverted "to the city banks and mail-order houses."

Reserve Board, it should be based on the transit time involved. If the maximum charge be one-tenth of 1 per cent, and not over 6 per cent interest is charged, the cost for nearby states would be one-twentieth to one-fortieth of 1 per cent. The Federal Reserve banks already follow this practice in their system of time schedules. Likewise, interest is sometimes allowed where remittance to a member bank is made in a New York draft. For example, the Federal Reserve Bank of Chicago will allow a member bank which sends checks on Chicago and requests a New York draft a discount of $7\frac{1}{2}$ cents per $1,000 per day for the time the draft will take to reach New York and be debited to its account. This is equivalent to paying interest of $2\frac{3}{4}$ per cent per annum. Instead of charging the member bank for the remittance it actually pays him for the use of his funds during the time the draft is in transit.[1]

If the Federal Reserve banks had been allowed to go forward without political interference, there is little doubt as to what the outcome of this controversy would have been. About one hundred years ago the Suffolk Bank of Boston met and overcame the opposition of the country banks of New England to par redemption of their bank notes. Over sixty years ago country clearing was introduced in England under the leadership of Sir John Lubbock. Today, in spite of the early opposition of country banks, clearing of out-of-town checks is as much a matter of course as clearing city checks.[2] When the Boston Country Clearing House undertook, in 1899, the collection of all New England checks, certain non-par banks strenuously opposed the plan.[3] In all these cases the sound principle prevailed and the opposing banks later supported the institution which at first they had so vigorously opposed.

The danger in the present controversy seems to lie in the political means which are being used. Although the opposition apparently comes from a comparatively small number of exchange-charging banks, seeking to protect their own profits, this opposition is now well organized and is carrying forward a shrewd propaganda. Efforts are being made to discredit other aspects of the

[1] *Bankers' Monthly*, April, 1920, p. 58.

[2] Hallock, *op. cit.*, pp. 38–39.

[3] *Ibid.*, p. 64.

Federal Reserve System, especially its failure to prevent price inflation during and after the war. The issue is now squarely before Congress to decide whether the par collection system shall be abolished or whether it shall become universal. The Federal Reserve Board has other vital problems pressing for solution. Moreover, it should not be expected to support this system unaided.[1]

Two years ago the Board stated: "The par collection system is not a local or selfish undertaking for the benefit of member banks, but it is a national enterprise for the convenience of the public and the promotion of commerce." Upon this sound fundamental principle it has been developed until it is almost national in its scope. Upon Congress rests the responsibility for sustaining the results already accomplished and giving to the Federal Reserve authorities the means for making the system universal.

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[1] Support for the position of the Federal Reserve Board is not lacking among the business interests of the country. In an address before the Chamber of Commerce of the United States at its seventh annual meeting in St. Louis, April 30, 1919, Wallace D. Simmons, president of the Simmons Hardware Company, upheld the Federal Reserve plan as sound and insisted that merchants must do their part to force country banks to remit at par. On September 26, 1919, the St. Louis Chamber of Commerce sent a petition to the Federal Reserve Bank of St. Louis to the effect that the real basis for handling country checks should be interest for the time required to convert checks into available funds. Similar action was taken by the branches of the National Association of Credit Men in the fourth district, which met in Cleveland early in March, 1920.